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BUILT WITH BRICKS, MORTAR AND BONDS

The Impact of the Massachusetts Health and Educational Facilities Authority on Massachusetts Institutuions

Senate Committee
on Post Audit and Oversight

Senator Louis P. Bertonazzi, Chairman

Commonwealth of Massachusetts

MASSACHUSETTS SENATE

The Honorable William M. Bulger
President of the Senate

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A Report of the

SENATE COMMITTEE ON POST AUDIT AND OVERSIGHT

Sen. Louis P. Bertonazzi, Chairman

Sen. Argeo P. Cellucci
Sen. Linda J. Melconian
Sen. Thomas C. Norton
Sen. Martin T. Reilly
Sen. Paul J. Sheehy

Prepared by the

SENATE POST AUDIT AND OVERSIGHT BUREAU

Lorllyn J. Allan, Esq., Director
Richard X. Connors, Counsel
Mary Anne Magiera, Chief Policy Analyst
James L. Hearns, Senior Policy Analyst
Robyn Lecesse, Administrative Assistant

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The Commonwealth of Massachusetts

SENATE COMMITTEE ON POST AUDIT AND OVERSIGHT

Room 314, State House Boston, MA 02133

Telephone 722-1420

SEN. LOUIS P. BERTONAZZI
Chairman

Members
SEN. MARTIN T. REILLY
SEN. LINDA J. MELCONIAN
SEN. PAUL J. SHEEHY
SEN. THOMAS C. NORTON
SEN. ARGEO P. CELLUCCI

LORLLYN J. ALLAN, ESQ.
Bureau Director

FOREWORD

Somewhat over two years ago, in May, 1986, the Senate Committee on Post Audit and Oversight issued its first report on an audit of a state "authority," an entity established by the legislature but given quasi independent operational and budgeting status. Since that first authority audit, the Committee has issued performance reviews on two additional authorities and, with this report on the Massachusetts Health and Educational Facilities Authority (HEFA), completes its fourth.

The Committee has purposefully undertaken reviews of this state's independent authorities: their number has proliferated, they operate with little or no legislative oversight, and yet they are responsible for meeting crucial public needs and serving vital public purposes. Accountability, adherence to legislative intent, and judicious application of their many powers must be assured.

The Massachusetts Health and Educational Facilities Authority is no exception. In its twenty years of existence, it has become the largest volume issuer of tax exempt debt in this state. It has never, in those twenty years, been the subject of a state audit or oversight from a legislative committee. Until eight months ago, however, it was the sole source for tax exempt financing for the physical plant and equipment acquisition needs of many of the state's most crucial and vital institutions: colleges, universities, hospitals, other health care facilities, and a multitude of cultural organizations.

How well has HEFA served the state in its role as financing conduit for these institutions? Has its public purpose been met? Has HEFA used its considerable powers and pivotal position judiciously and well? These questions, which the Committee sought to answer in its audit, defied clear and unambiguous answers. The Committee found that HEFA, in many of its operational aspects, was exemplary. The benefits of HEFA financing to those institutions which have used it were visible and substantial. Yet, in many areas, HEFA has fallen short of realizing the broad public role envisioned for it. It has instead displayed a lack of concern for and insensitivity to much of the public purpose aspects of its existence.

Consequently, the picture painted of HEFA is often one of contrasts: it is highly respected as a meticulous, thorough issuer of high quality bonds, but berated as insular and overly conservative. Its constancy over the years and tightly controlled issuance process are praised as its source of strength while also condemned as its major weakness and the cause of alienation.

However characterized, HEFA's approach to its mission, the role it has created for itself, and its very existence all are now under siege, making change inevitable. Recent and proposed changes in state laws, federal tax law limitations, and the need to shift its emphasis to one of managing a substantial amount of outstanding debt have forced HEFA to reassess its approach and methods and to subject itself to strong self scrutiny.

The Committee supports HEFA in its recognition that change is needed, but cautions that such change may be too long overdue. To fully meet its mandates and serve its constituent communities, HEFA must aggressively reach beyond its self-imposed isolation and become more responsive to the many diverse but vital interests and concerns of this state's non-profit institutions. There is no doubt that HEFA has benefited many. But it also has closed out significant segments of those industries it was meant to serve. Its cautious approach has made it highly trustworthy, but also has precluded creative use of financing options and marketing strategies for those perhaps most in need of its expertise and advice. Its intense concern for maintaining a highly credible position for itself in the financial markets has assured consistent, irrefutable quality in its bond offerings. But it also may have blinded the agency to changes in its constituent environment which called for changes within itself.

During this audit, HEFA executive and administrative staff gave the Committee full and complete cooperation and assistance, as did many others in financial, educational, cultural and health care related organizations. The Committee appreciates that assistance and the candor shown throughout our audit. It hopes that this report and its recommendations and findings will be of assistance in turn to those who work with and within HEFA and the many non-profit institutions which are its clients.

Sincerely,

Louis P. Bertonazzi

LOUIS P. BERTONAZZI
Chairman

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EXECUTIVE SUMMARY

The Massachusetts Health and Educational Facilities Authority, in existence since 1968, is the state's largest issuer of municipal bonds. The Authority, or HEFA, has issued approximately $5.7 billion in tax exempt bonds primarily benefiting private, non-profit colleges, universities and hospitals. This sizeable debt, issued on behalf of approximately 135 organizations, is secured and paid for by revenues from the financing institutions. The Commonwealth is in no way legally liable for this debt, nor is HEFA. However, as a major player in the municipal bond market and as an issuer of financial paper bearing the state's name, HEFA is viewed by legislative and fiscal experts as having influence on the cost of that financial paper as well as the interest paid by the Commonwealth on its own bonds.

HEFA was created to serve a specific public purpose--the expansion of resources and services in the areas of education, culture and health services. It was to do this by providing access to or being a "conduit" for low cost financing for the physical plant expansions and state of the art equipment acquisitions needed by the state's educational and medical institutions. To maximize its ability to accomplish this public purpose, the legislature exempted HEFA from most state laws governing budgets, appropriations and personnel and purchasing practices.

Consequently, HEFA has been virtually autonomous for a number of years while it has issued sizeable debt on behalf of organizations that have a significant impact on the economy and quality of life in Massachusetts. For these reasons, the Senate Post Audit and Oversight Committee undertook a review of the Authority.

The dollars raised by the sale of $5.7 billion worth of HEFA bonds has had a significant impact on the physical assets of the state's independent colleges and universities and on its health care industry, enabling these industries to expand and update services and effectively compete with each other and publicly owned institutions for students and clients during the post war boom years. The Committee found that HEFA is widely known and well respected as an issuer of quality and of strength. Its quality is primarily attributable to its meticulous and technically flawless process which has, over the past two decades, assured buyers of Massachusetts municipal paper access to prestigious and top rated bonds without incident of default. At the same time, HEFA's strength has caused differing reactions among its constituent groups, much of which has been unfavorable.

Unlike most of its peers in other states, Massachusetts' HEFA has focused much of its attention over the past twenty years on developing a reputation and identity of its own as an organization with presumed power and influence distinct from its client institutions. HEFA has achieved this status by tightly controlling the process through which all eligible non-profit organizations access the bond market. The Authority has principally relied on non-staff consultant advisers to manage its process, with as few as three individuals over the entire two decades offering key advice on most of HEFA's activities. HEFA's selected consultants determine all factors related to a financing, including whether it should be done, the collateral required and its financing mechanism and structure. The Committee found disturbing HEFA's preoccupation with its own agenda and its unbalanced reliance on limited sources of advice. The Committee feels that, because of this, the Authority's principals through the years have missed many key signals telling them that HEFA needed to change and improve as its constituent segments grew and matured into financially sophisticated and economically important Massachusetts industries. In addition, HEFA's narrow view of its mission and reluctance to reach outside itself has deprived the state of the benefit of HEFA's collective skills and expertise in debt financing, bond markets and certain aspects of its constituent industries. The Committee feels that HEFA's role in the development and continued assurance of the financial soundness of its constituency is too important to be executed in isolation.

In the Committee's opinion, HEFA's ability to function in tandem with others--its constituents, state officials, public policy makers and so forth--will prove key to its survival as it enters its third decade. HEFA is currently under siege. As a result of the 1986 federal tax law changes limiting many benefits previously allowed non-profit organizations and the continuing volatility of the securities market, HEFA has probably seen the last of the exciting and lucrative years of large and multiple issues. Instead it will, of necessity, have to focus on effectively caretaking its approximately $3.9 billion of outstanding debt. This effort will become increasingly difficult as the ability to pay that debt is affected by continually rising health care costs and predicted demographic downswings, events which may result in hospital closings and a dwindling pool of college applicants.

In addition, in January, 1988, Chapter 769 of the Acts of 1987 was enacted, giving the Massachusetts Industrial Finance Agency (MIFA) authorization to do tax exempt financings for a large percentage of the same non-profit organizations previously required to finance exclusively with HEFA. The new law has instigated competition between the two issuers, providing incentive for HEFA to evaluate some of its policies and practices. But time may run out for HEFA since in this legislative session a further change has been proposed which would effectively eliminate HEFA by merging it with MIFA.

The Committee feels some positive benefits can result from the current situation, primarily in the form of increased competition among investment bankers attempting to develop creative and low cost financing packages for both agencies. However, assuming HEFA's continued existence, the effects of that competition over the longer term will have to be carefully monitored to assure that the state's interests are adequately protected, as well as those of current bond holders and of the state's non-profit organizations and the economically important industries they constitute.

The Committee believes HEFA needs to involve itself with others as it takes on the challenges of its third decade, and several recommendations were made to that effect. Chief among those is the suggestion that HEFA use a recently established Board committee as a springboard for reviewing its understanding of its mission and its operations, policies and practices, and testing those against the current needs of its constituency and the Authority's responsibilities as a public entity. The Committee agrees with those who feel that HEFA needs to make some changes and would like to see the Authority be responsive to creative and constructive suggestions for that needed change.

I. INTRODUCTION

Responding to a national trend, the Massachusetts legislature in 1968 created what is now known as the Massachusetts Health and Educational Facilities Authority. This Authority was established as an autonomous, quasi public agency and designed to be an advantageous link between the state's non-profit institutional sector and the municipal bond market. The federal government had made clear to states its intention to phase out the popular post war programs that had loaned money to colleges and hospitals to build needed facilities. Responding to this, many states, particularly those in the Midwest and East, moved quickly to fill an anticipated resulting void in available low cost construction funds needed to meet the rising demands for educational and health services in the 1960's and 1970's. The states looked to municipalities and the way they funded construction projects as a model and set up what is commonly referred to as "conduit" or "pass through" agencies and authorities. These agencies and authorities were given the power to issue bonds and notes on behalf of non-profit institutions and also were authorized to issue bonds that are exempt from federal and state taxes, a factor that has been key over the years to making both the issuers and their financial paper attractive and enduring commodities.

Massachusetts HEFA has existed for twenty years. During that time it has become the largest volume--$5.7 billion--issuer of tax exempt debt in the Commonwealth and one of the largest in the country. This sizeable debt, issued on behalf of approximately 135 institutions, is secured by and paid back from revenues of the institutions for which the financing was undertaken. The Commonwealth is in no way legally liable for this debt. However, as a major player in the municipal bond market and an issuer of financial paper bearing the state's name, HEFA and other authorities with similar powers are viewed by legislative and fiscal experts as influencing the cost of that paper as well as the interest paid by the Commonwealth on its own bonds. And, although the Commonwealth is not liable on HEFA arranged debt, there is the possibility of "political" fallout in the event of hospital or college closings or bond defaults as predicted economic and demographic downswings affect the revenue sources of HEFA related institutions.

HEFA was created by statute to serve a particular purpose: facilitate expansion of resources and services in areas of education, culture and health services by providing low cost financing so that facilities could be expanded and necessary "state of the art" equipment purchased. Because provision of these services was thought to be important to the health and welfare of the citizens of the Commonwealth, or, as stated in HEFA's enabling legislation, was needed for "the public benefit and good," the legislature exempted HEFA from most state laws governing budgets, appropriations and personnel and purchasing practices. Similar exemptions had been granted other authorities. In other words, the legislature freed HEFA from the often complicated and time consuming constraints placed on regular state agencies and allowed it the luxury of irregular scrutiny.

Its enabling law provides that HEFA, like other state authorities, be governed by a citizen board of nine people, all appointed by the

Governor. Six members of the HEFA board must have certain industry or professionally related affiliations or expertise and three are appointed "at large." Unlike many other state authorities, the HEFA board does not by law or otherwise include an official of the state's executive branch or a member of the legislature. The HEFA board is authorized to hire professional staff, establish policies and practices and make all other decisions necessary to effect its legislative mandate.

By exempting state authorities from certain restrictions and conferring their boards with broad-based powers, the legislature never intended, however, for those agencies to go off and "do their own thing." Although restrictions have been relaxed, the expectations for state authorities are similar to those of state agencies and specifically include an assumption that their services be broad-based, of durable quality and subject to public accountability.

The Senate Post Audit and Oversight Committee undertook this review of HEFA both because of the large volume of debt issued by HEFA and because of the effect HEFA's institutional clients have on the economy and quality of life in Massachusetts. There has been no recent review of HEFA operations by any state oversight unit. HEFA is audited by the accounting firm of Price Waterhouse, Boston, and since the late 1970's, the state Auditor has accepted that arrangement as meeting the auditing requirements for state entities. The Committee believes, however, that consistent performance reviews of independent authorities is healthy and selected HEFA as the fourth in its series of quasi public agency audits.

In conducting this study the Committee employed a standard research approach of interviewing HEFA staff, HEFA board members, and key personnel involved with establishing policies, facility planning and programs in the areas of finance, education, health care and cultural affairs. The Committee also reviewed official reports and other documents produced in the normal course of agency operations, reviewed authority files and referenced relevant literature and independent studies. In addition, the Committee interviewed approximately 30 individuals who represent various types of professional firms that are active in the financial market at the state, national and international levels, the majority of whom have dealt directly with HEFA and/or its various client institutions. The Committee also visited twenty non-profit institutions which have either used HEFA issued bond funds or are eligible to do so. The research was conducted between November, 1987, and May, 1988.

The Committee would like to note that the HEFA Board, administration and staff fully cooperated in this performance audit. The Committee appreciates their willingness to be straightforward, thorough and patient in what was a complicated, extensive and often intrusive process.

II. MASSACHUSETTS HEFA: ITS DEVELOPMENT

A. Background

HEFA, established in July, 1968 by a special act of the Massachusetts legislature (St. 1968, c. 614), was originally designated the Educational Facilities Authority and empowered to finance projects for higher education. Before it got organized or issued its first bonds in July of 1970, the Authority's legislation was amended twice. Chapter 454 of the Acts of 1969 added hospitals to the institutions which the Authority could finance and renamed the Authority the Health and Educational Facilities Authority. A second amendment, Chapter 332 of the Acts of 1970, added savings and cooperative banks to the list of institutions eligible to invest in HEFA bonds. Essentially, private, non-profit institutions are eligible for financing through HEFA. These institutions are usually referred to as "501 (c)(3)" organizations, derived from the federal taxation code category under which they qualify for certain tax benefits. The purpose of the Authority, as set out in its enabling legislation, is to assist these institutions in the acquisition, construction, financing and refinancing of projects. HEFA is essentially a financing mechanism--a conduit or facilitator--which uses its power to issue debt as a way of providing funding to other organizations. The Internal Revenue Code exempts from taxation any debt issued by state and local governments on behalf of 501 (c)(3) organizations as long as at least 90 percent of the funds are used for a project related to the tax exempt purpose of the organization. HEFA bonds are generally considered as revenue bonds of the particular non-profit organization. What HEFA does is to basically serve as an intermediary whose presence qualifies the bonds for tax exempt status.

The "projects" considered eligible for HEFA financing are liberally defined by statute and include just about anything necessary to the operation of an institution and its provision and support of services. Excluded are those items generally considered annual operating expenses, such as books, fuel, office supplies, and so forth. Also excluded are any facilities or parts thereof that are to be used for any sectarian or religious purposes. HEFA may, however, finance the purchase of capital assets such as high technology health care equipment, telephones, computers and other mechanical equipment. Generally, items purchased in this category are expected to have an extended institutional life.

HEFA is authorized to accomplish its purpose through the issuance of revenue bonds and notes in varying forms and for varying terms. For instance, it may issue debt for immediate use by an institution in the construction process in the form of a bond anticipation note. The Authority primarily deals in more permanent, long term financing afforded by fixed or variable rate bonds. HEFA also has the authority to advance refund issues--set bonds aside for later use. All bonds and notes issued by HEFA are backed and paid for by the institution for which the financing is undertaken. This includes principle, interest, and all fees related to the sale.

Bonds issued are secured by HEFA through liens against the institutions' primary source of revenue--income from tuitions, health care service delivery, and so forth, and its real estate. All HEFA bonds are issued with explicit statements detailing the absence of liability by the Commonwealth of Massachusetts. HEFA bonds do not, in any way, constitute a debt or liability of the state. They do not pledge the faith and credit or taxing power of the Commonwealth, nor do they constitute a "moral" obligation on behalf of the state. HEFA can issue bonds or notes in its own name, but does not have power to raise revenues independent of its institutional benefactors.

HEFA's singular distinction is its qualification for federal and state tax exemptions for the bonds issued. The exemptions, particularly from federal taxes, make HEFA bonds attractive because, in most cases, buyers do not have to pay federal or state taxes on the earned bond interest. The taxation exemptions, coupled with the prestige and trendiness of owning financial paper bearing certain institutional monograms, has given HEFA, as the issuer, leverage and popularity. Although a few institutions could access bond markets on their own, it would be without the advantage of the tax exemptions. And, until this year, HEFA was the sole proprietor of this privilege for Massachusetts 501 (c)(3) organizations. However, Chapter 769 of the Acts of 1987 was enacted in January, 1988. It amended the enabling legislation of the Massachusetts Industrial Finance Agency (MIFA), authorizing that quasi public agency also to provide tax exempt financing for the majority of the state's 501 (c)(3) organizations. A later chapter in this report will discuss the ramifications of that legislation. Both agencies are also authorized to issue taxable bonds for these organizations.

In addition to the ability to issue bonds, the Authority is empowered, among other things, to: acquire real and personal property and to manage, enhance, alter or regulate it in any way; mortgage or lease property; make loans; sue and be sued; enter into contracts and accept loans; assess fees for services, and control its own funds and personnel. The Authority also has power to acquire any federally guaranteed security (FHA, Ginny Mae, etc.) and to pledge or use such security to secure or provide for the repayment of its bonds. Additionally, the Authority may undertake joint projects for two or more participants.

The majority of the Authority's basic powers were spelled out in its original, 1968 statute. However, there have been ten subsequent amendments to HEFA's enabling statute which have included technical and substantive changes.

In addition to the amendments cited earlier, the amendments include:

1. Chapter 1063 of the Acts of 1971 which changed the name of the Authority for a second time to the Massachusetts Health and Educational Facilities Authority, the name currently in use. In addition, technical amendments were made which include permission to purchase a blanket surety bond to cover board members and employees; delegation to the executive director of the power of sale in the case of competitively bid and negotiated public sales, and clarification that the lien which

the Authority takes on revenues of an institution is superior to a lien on an institution's receivables.

2. Chapter 769 of the Acts of 1979 which added authorization for HEFA to purchase federally guaranteed securities and also established a more open process for selecting consultants for Authority required feasibility studies which determine institutional debt financing abilities.

3. Chapter 268 of the Acts of 1980 which provide that savings banks as well as trust companies may act as corporate trustee for bond issues.

4. Chapter 482 of the Acts of 1980 which redefined HEFA eligible "hospitals" as inclusive of licensed health maintenance organizations.

5. Chapter 777 of the Acts of 1981 which added cultural institutions to the 501 (c)(3) organizations for which the Authority may do bond financing and made some minor technical changes.

6. Chapter 523 of the Acts of 1983 which clarified the Authority's ability to finance equipment regardless of whether its purchase was associated with a construction or renovation project.

7. Chapter 419 of the Acts of 1984 which added schools for the

handicapped to the list of organizations for which the Authority may do financings.

8. Chapter 789 of the Acts of 1985 which permits the Authority to finance non-profit corporations which are affiliated with hospitals and carry out hospital functions but which have not been issued hospital licenses.

B. The Governing Board

For HEFA and most other quasi public agencies, the responsibility of making reality out of the public policy mission statements and other stipulations set out in enabling legislation rests with a gubernatorially appointed citizen board. These boards are more than advisory--they are ultimately responsible for the actions of the agency. Most appointees, like those on the HEFA board, serve without compensation, except for the reimbursement of necessary expenses incurred in the performance of their duties. These boards, in turn, are authorized to appoint an executive director and other staff to manage the day to day details at the operational level.

The HEFA governing board includes nine people who are appointed for seven year terms that expire according to a staggered schedule. Six members, by law, must have certain industry or professional affiliations while three need not have any specific associations. At least two members have to be associated with institutions of higher education and two with hospitals. The HEFA legislation also specifies that there be at least one member of the board knowledgeable in each of the fields of state and/or municipal finance and building construction.

Committee interviews and analysis of public records indicate that the HEFA board has had minimal turnover in the twenty year history of the Authority, a situation that is viewed with differing opinions. For example, although 20 different individuals have served on the HEFA board, nine have served for a decade or more and only four appointees have served three or fewer years. In addition, two current board members have served on the board since it was first appointed by then Governor Francis X. Sargent and have been reappointed by two different governors. Until his death last year, a third individual had also been on the board since it was first created. Additionally, it has been the custom of the HEFA Board itself to identify and nominate individuals to the Governor for appointment and reappointment to the Board. With few exceptions, those recommendations have been honored. Some, like those directly associated with HEFA--current board, staff and consultants--consider the low turnover "stabilizing." On the other hand, some who deal with HEFA see the situation as "insulating" and a hindrance to change.

As detailed in annual reports and other documents, HEFA Board members have extensive and distinguished community service affiliations and varied professional expertise, including memberships on the governing boards of several institutions that have been issued HEFA bonds. HEFA's enabling legislation clearly encourages and provides for this kind of overlay, exempting members from conflict of interest law violations as long as they refrain from discussions and votes when a conflict does arise. Lacking, however, is a direct, positive link between the HEFA Board and a related state policy maker or administrator. Except for one member of the initial HEFA Board, there has been no formalized and ongoing link between the Board and officials responsible for formulating public policy and/or administering public programs. The initial Board membership included one individual, who, at the time of appointment in 1969, was also serving as the state's Deputy Commissioner of Public Health. However, that person left his position three years later, but continued to serve on the Board until 1987.

The absence on the Board of an individual familiar with state policies and changing public needs in areas such as finance, health care, education and cultural affairs is compounded by the HEFA Board's failure to formalize a process to keep its members informed on these issues. The Board does get limited information relating to public policy and legislative issues at regularly scheduled monthly meetings. But discussions are brief and usually limited to matters directly affecting HEFA. The HEFA staff also prepares various reports for the Board from time to time dealing with higher education and health care related institutions as industry segments and their performance in relationship to one another as financial entities.

However, Committee interviews revealed that the HEFA board has made a conscious effort to stay away from the arena of state administration, public policy and politics. Although individual HEFA board members, from time to time, have been involved in various policy discussions involving HEFA or a constituent institution, as a unit HEFA is very concerned about remaining "apolitical." Generally, HEFA Board members feel that the legislature gave them a job to do, provided the details in the Authority's enabling legislation, and that they have proceeded to do that assignment with diligence and responsibility. The apparently unspoken question is: ".. So, what more do they want?" Those interviewed said HEFA Board members and staff, over the years, have been concerned that any association with legislators or administration policy makers could leave them vulnerable to political influence and their actions suspect as politically motivated.

The Committee feels the consequences of this approach have been unfortunate. HEFA Board members, although individually knowledgeable and experienced, as a collective body have had little impact on matters relating to the critical issues facing the state in the areas of finance, health care, education and cultural affairs. The Committee feels HEFA's collective skills and particular experience in debt financing, bond markets and certain aspects of its constituent industries would add a welcome dimension to public policy debates. HEFA's role in the development and continuation of financial soundness within its constituency is too important to be carved in virtual isolation.

Similarly, according to those interviewed, the HEFA Board also has distanced itself from its constituency. Board meeting minutes show that there has been very limited use over the years of subcommittees and an absence of such things as advisory units or task forces that could provide using institutions formal and frequent access to the Board and which could maximize the leadership potential and skills present on the

Board. The Board has elected, instead, to rely on an "informal" committee structure and the polling of members on some issues. Generally, the full Board makes decisions based on information most often prepared by consultants. Some change has occurred recently, but generally staff and representatives of using institutions have had very little involvement with Board members.

C. Policy Perspective

To help it test and assess the validity of HEFA's posture on public policy involvement, the Committee sought out individuals who, as public policy makers, participated in the deliberations that resulted in HEFA's creation. Those interviews provided the Committee with a window on the past, and helped clarify legislative expectations of quasi public authorities. There are twenty four major quasi public agencies in Massachusetts and HEFA is among the largest block of nine that were created during the 1960's. Those interviewed said the legislative tendency then was to give those agencies broad, rather than specific, mandates; they were created to accomplish broad public purposes and legislators wanted to allow them freedom to do the job.

A key former legislative leader pointed out, however, that regardless of the broad nature of an authority's preamble and in spite of the absence of legislative restrictions, "The legislature always intended that quasi public agencies stay within the purview of the legislature." In reference to HEFA, he added, "The legislature expects feedback from off-budget authorities and that should take the form of something more than the required filings of annual reports and notices." He also stated, "The expectation is that quasi public agencies will communicate with the legislature when situations change, when changes are needed in their legislation, and also when situations arise that legislators ought to be concerned about...it was never intended that they should go off and do their own thing, never to be heard from again." He concluded, "Quasi public agencies were set up to serve the citizens of the Commonwealth and not the institutions they service...in hindsight, the legislature probably erred in not making them report to a legislative committee."

HEFA's long standing practice of noninvolvment and its self-induced anonymity have had unfortunate consequences. The Committee found that HEFA's governing Board and administration, as well as its services, are little known and less understood beyond the group of 135 organizations that have benefited from its tax exempt financings. Additionally, established perception of isolation and aloofness is extremely difficult to counter. HEFA's current Board Chairman, with assistance from a newly formed committee, has made improving the Authority's "image" a priority. However, the Committee was just recently appointed--April 5, 1988. And, although it has support confirmed by a Board authorized minimum expenditure of $75,000 for improving HEFA's image and its external relations, its formation comes at the outset of the third decade of the Authority's existence and on the heels of legislation which has provided 501 (c)(3) organizations with the option of electing to do tax exempt financings through another quasi public authority.

III. HEFA DEBT FINANCING

A. Overview and Impact

With $5.7 billion worth of bonds issued, HEFA leads the more than two dozen quasi public state authorities in the issuance of municipal bonds. As the leader it has been a major player in Massachusetts' dramatic shift upward in the overall issuance of municipal bonds. According to information and charts detailed in the Senate Ways and Means Committee Fiscal 1986 Budget recommendations, municipal bond offerings from state authorities rose more than 12 percentage points from 1977 to 1982. After moving during that period from 56.4 to 68.8 percent of bonds issued, in 1982 authority bonds represented $1.6 billion compared to about $450 million in state bonds and $250 million in city and town bonds. Continuing an upward spiral, in 1984 eight of the authorities issued over $2 billion in bonds compared to the state total of $380 million. HEFA alone issued $876.5 million, or 44 percent, of the authority issued debt that year. In each of the next two fiscal years preceding the major federal tax reform activities of 1986, HEFA continued to issue record amounts of debt, exceeding $1.1 billion each year. As the Senate Ways and Means Committee document points out, "the magnitude of the Authorities' bond issuance clearly dominates the Massachusetts bond market."

The 1986 tax law changes and the instability of the financial markets have served to considerably slow issuing activity. However, because the debt issued is long term, much of it extends for 20 to 30 years. The

Committee is aware that HEFA bonds bear no explicit state commitment to the Authority's bond holders. However, the Committee is also cognizant of the "political" reality that the need to protect the state's bond rating would probably force it to assist other entities, such as HEFA, if they face financial difficulties. As pointed out in the Senate Ways and Means Committee report, "The 'domino' effect of the Authorities' financial failures has been documented in recent history in states such as New York and Washington, and in Massachusetts in 1975." For that reason, the Committee shares concerns expressed by the Ways and Means Committee that the future financial stability of the state may be largely in the hands of organizations subject to little oversight or control by elected officials and taxpayers themselves.

The $5.7 billion of debt issued through HEFA has had significant impact on the physical assets of and the ability to offer expanded and updated services within the private higher education and health care industries of Massachusetts. The debt financing mechanism offered through HEFA provided these sectors a means in addition to gifts, grants and raised funds to expand during the post war baby boom years and to effectively compete with each other and the public sector for students and clients. Because of HEFA policy and more recent statutory authorizations, the Authority's impact on the state's cultural sector, schools for the handicapped and nursing homes is much less obvious.

However, according to HEFA, 135 different organizations have been issued bonds of one kind or another. The funds made available from the sale of those bonds have been used to construct classroom facilities, dormitories, sports and recreation complexes, emergency medical service areas, surgical suites, intensive care bed space, power plants, recording studios, theaters, faculty office space and much more. In addition, bond proceeds have been used to renovate already existing facilities and to refinance a debt previously committed to from other institutional sources. Refinancings are usually done to obtain better interest rates or to free revenue from unrestricted sources. Additionally, in 1984 and 1985, HEFA issued a series of four capital asset pool bonds making $495 million available to organizations primarily for expensive, extended life equipment such as telephone and computer systems and health care diagnostic equipment such as magnetic resonance imaging (MRI) machines.

HEFA bonds are either privately placed or publicly sold, either by competitive bid or through a negotiated sale. According to HEFA documents, as of December, 1987, the Authority has been involved with 318 financings since its first in 1970. Of those, 182 have been stand alone financings--single institution, rated or insured offerings--and 136 have been capital asset pool loans, a simpler, credit enhanced, codified loan process. More than two thirds of these financings have been done since 1984.

HEFA documents indicate that between July, 1970 and the end of fiscal 1987 exactly $5,716,510,000 in bonds, bond anticipation notes and loans have been issued to various 501 (c)(3) organizations. $1,172,862,000 of that amount has been retired, since much of it was issued in bond anticipation notes prior to institutions securing permanent financing. An additional $601,037,000 has been advance refunded, basically set aside in escrow for later use, leaving the Authority with $3,942,611,000 debt issued still outstanding. As of March 23, 1988, HEFA had issued an additional $235,301,981 in bonds and the Authority expected to market another approximately $95 million prior to the end of the fiscal year 1988 in June.

B. HEFA's Clientele

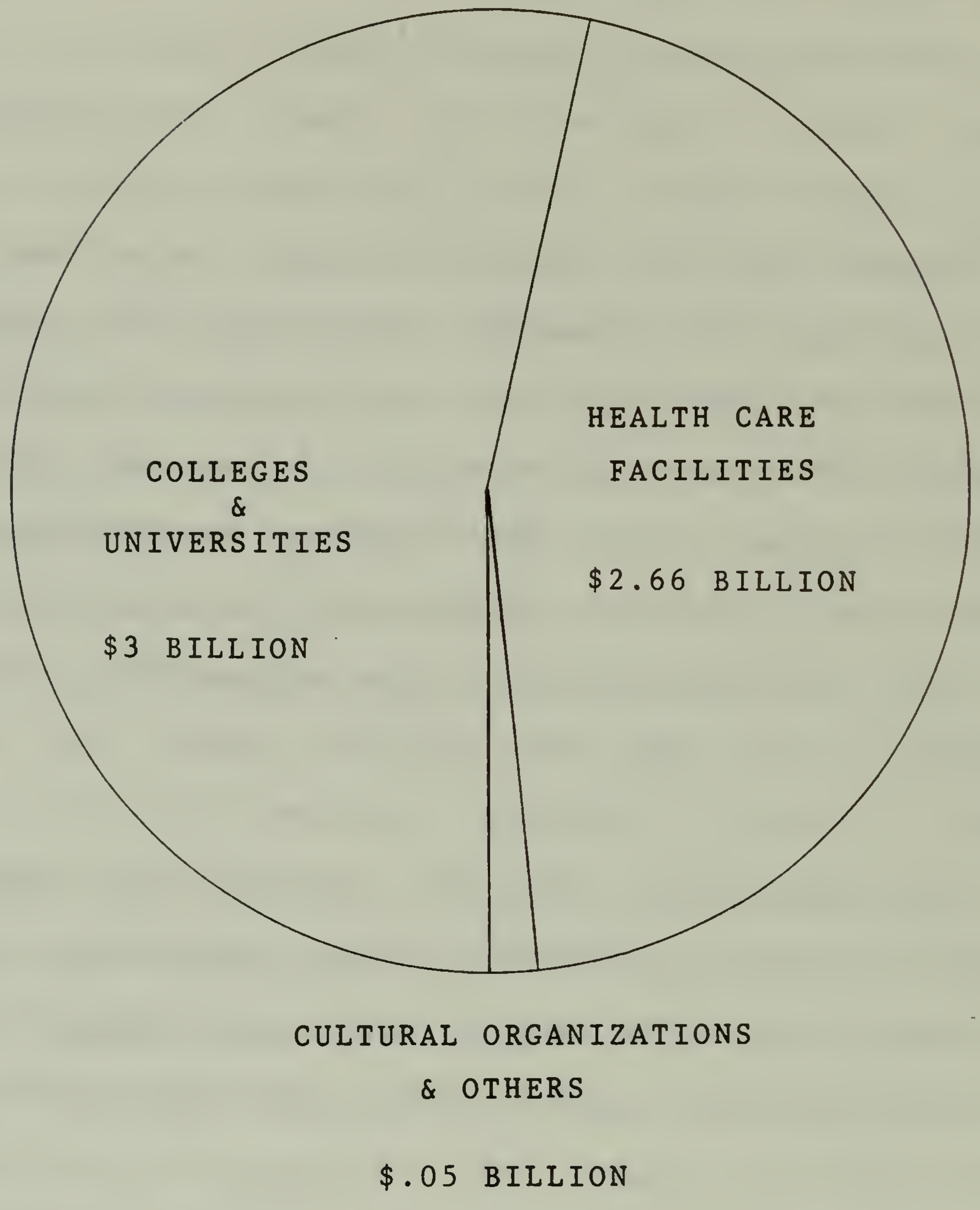
The Committee reviewed HEFA activities for a five month period, from late November, 1987 through April, 1988. The entity and image presented, however, has been created by two decades of policies and practices. Some of those have been praised, but many were characterized as unpopular and viewed as inhibiting by the institutions HEFA was designed to serve. The Committee's analysis of the exacting, multifaceted process employed by HEFA in the issuance and monitoring of funds points out flawless, efficient, and thorough practices that many public agencies could emulate. But the Committee's analysis of amounts issued and organizations benefiting most from HEFA's availability raised concern about this agency which has been virtually ignored and given minimal scrutiny but which has a wide ranging and lingering impact on five key sectors of the Massachusetts economy and on its quality of life.

For example, only 135 organizations have been issued bonds through HEFA, although there are anywhere from 900 to 1800 organizations included in the HEFA eligible catagories, depending on whose numbers are used. Although there are some legitimate limiting factors involved for some categories of qualified organizations, the number of institutions that have accessed the bond market through HEFA is proportionally very low. Some of the limitiations are in the HEFA statute itself, particularly those affecting cultural institutions. To be eligible for HEFA financing, a cultural organization must be a major regional resource, provide advance level educational services either to its own or other students and demonstrate broad community support through its fund raising abilities. Schools for the handicapped, likewise, have to establish that they are a major resource for the handicapped population and be a certified school under the state's handicapped student laws, commonly referred to as Chapter 766. However, there are only six organizations in each of these categories that have done financings through HEFA since they became eligible, cultural organizations in 1981 and schools for the handicapped in 1984. Nursing home financings have been possible only since 1985 and those facilities, in addition to having 501 (c)(3) status, must be affiliated with a hospital. There has been only one financing in this category.

The Committee's analysis of the $5.7 billion issued focused on the two segments with the largest volume: higher education and health care related organizations. The analysis used various documents provided by HEFA and includes dollars made available through individual financings as well as capital pool loans. For the purposes of the analysis, the Committee allocated unassigned pool dollars to each of the five segments based on a percentage of usage thus far and rounded up to the $5.7 billion of bonds issued (Figure I).

FIGURE 1

CAPITAL EXPANSION WITH HEFA BONDS



The largest volume of bond dollars--approximately $3 billion--has been issued to educational organizations. Although the Authority has primarily dealt with colleges and universities, by law, it can issue bonds to any licensed non-profit educational institution in the state which is authorized to provide a program of education beyond the high school level. The New England Board of Higher Education lists 89 degree granting Massachusetts non-profit independent colleges in its 1987 fact book. However, when other eligible educational institutions or organizations are included the list increases to as high as 155. To the Committee's knowledge, HEFA has done one financing for a non-degree granting organization under its educational institution authorization. There are 46 individual educational institutions which have been issued HEFA bonds since 1970. Four of those, Harvard University, Boston University, Boston College, and Massachusetts Institute of Technology, have been issued nearly $1.9 billion, or 63 percent of the amount issued to higher educational institutions. Harvard alone has been issued $1.36 billion in bonds or nearly a quarter of the total amount of bonds issued by HEFA in all the years it has existed. The remaining approximately $1.1 billion in bonds was issued to colleges and universities located throughout the state.

A large percentage of the bonds issued to higher educational institutions was issued the two fiscal years just prior to the time the 1986 tax law changes took effect. In fact, HEFA did its largest total volume of business--approximately $1.2 billion each year--in fiscal 1985 and 1986. It is common knowledge that many of the tax reforms were anticipated well in advance of 1986 and institutional financial officers planned accordingly. Although HEFA, with help from the large and influential block of 501(c)(3) institutions, was able to escape an overall cap on the amount of tax exempt bonds it can issue, it did not survive tax reform unaffected. Congress instead capped at $150 million the amount of outstanding tax exempt debt individual institutions may hold, with the exception of debt related to acute care facilities. In addition, the practice of earning interest above the amount due bondholders from escrowed bond funds, known as positive arbitrage, was curtailed.

As a result of activity prior to tax law reform, three of the four largest users of HEFA's services, Harvard, Boston University and Boston College, all exceed the $150 million tax exempt bond financing cap and hence will not be able to add to their debt financing through HEFA for a number of years, anticipated by most to be about five years.

In contrast, construction bonds issued on behalf of the Massachusetts' public sector of higher education total only $1.36 billion for the 25 years between 1963 and 1988. Issued by the Commonwealth itself and the various affiliated dormitory authorities, the largest volume of these bonds was issued during the 1970's and the last major financing of $155 million was done in 1983. The largest systemwide financing in a single year was only $258.3 million in 1970. HEFA's financings on behalf of private higher education have matched or exceeded that amount every year since 1980, more than doubling it in four of those years. According to enrollment statistics published for both systems for the 1985 academic year by the New England Board of Higher Education, there were approximately 160,000 students enrolled in degree programs in Massachusetts' public colleges and universities and 220,000 enrolled in the non-public sector.

Health care providers in Massachusetts, including hospitals, health maintenance organizations, research and teaching facilities, and rehabilitation and specialized care centers, comprise the second largest block of HEFA's constituency, accounting for approximately $2.66 billion of dollars issued. According to the state Department of Public Health and the Division of Insurance, which share licensing responsibilities for them, there are 111 non-profit, licensed hospitals and health maintenance organizations in Massachusetts. But in the health care sector, a few institutions, mostly Boston based teaching hospitals, account for a large portion of bonds issued. For example, of the 76 different organizations issued bonds in this category, the six which have received approximately 40 percent or $1.1 billion of the amount issued include Massachusetts General Hospital, New England Medical Center, Beth Israel Hospital, Children's Hospital, Brigham and Women's Hospital and Harvard Community Health Plan. The remaining 70 bond fund users in the health care area have been issued approximately $1.5 billion and include a broad cross section of hospitals and specialized care facilities across the state. A large percentage of the community hospitals represented are HEFA users mainly because they have been allowed to access the capital asset pool loan funds which became available as recently as May 1, 1984.

C. HEFA Process

Has it been by design and advantaged circumstances, or by happenstance over the years, that some organizations have been more involved with HEFA than others? Does the HEFA debt financing process itself encourage or discourage involvement? Does it matter? To public policy observes, those questions carry significance. But HEFA is a financing entity, working and dealing in a market place that is governed only by the bottom line. To survive and manage well its financing mission, HEFA, even though it is a quasi public agency, must in the bond marketplace be hardnosed and adept at the rules of financings. Yet, because it is a quasi public agency with a public purpose and mission, HEFA fairly is also judged by standards of public accountability.

After five months of research, many broad ranging and intensive interviews, and serious analysis, the Committee has not established conclusive answers to any of the above questions. The Committee did establish that there are very logical, reasoned positions, supported by some facts, statistics, theories and professional judgements, for findings on both sides of the questions. However, time, evolving administrations and practices and the residual emotional effects of the often demoralizing and humiliating process of borrowing money--even at the institutional level--seem to have blurred the possibility for clear answers to what the Committee feels are both obvious and germain questions. Instead, what emerged is a pattern of a series of factors which affect accessibility to HEFA and HEFA's influence in bettering the state's position in areas germain to its mission, namely, education, health care and cultural affairs. A look at the HEFA process, and its reported effect on actual and potential users, follows.

The Committee discovered that, clearly, organizations that were the most informed about HEFA and financing options and had reasonably skilled and/or persistent financial administrators were most likely to use HEFA's services and were most comfortable with the process. HEFA itself is not a common resource for non-profit debt financing information and is not often even the source of information about its own services. Although many organizations contacted made note of the fact that HEFA's outreach has improved dramatically in recent years, it is still widely unknown and considered a non-user friendly commodity. The first step of the long process of debt financing, one which may or may not involve HEFA, is taken at the 501 (c)(3) institution when it decides to borrow money to pay for capital needs resulting from program or service expansion or outdated and dysfunctional equipment and physical plant. The nature of a non-profit institution dictates that the most cost efficient way to obtain that financing must be selected and it is in the search for that "best way" that HEFA's name is raised. HEFA may be mentioned by the institution's investment banking firm, a member of its board of trustees or its chief financial officer. Although financing through HEFA is expensive, most financial experts interviewed felt that because of the tax free status of the bonds, the long term costs of the overall financing are less through HEFA and are rarely matched by other financing sources such as a local bank. The fact that HEFA's bonds are the best deal is what brings organizations to its door.

On HEFA's part, its policy, expressed by the current administration and Board and in documents and meetings minutes from years past, is "HEFA tries to fund every project that has come to us as best we can...."

HEFA is administratively set up to respond to an inquiry but not to initiate. Upon inquiry, HEFA sets in motion certain fixed steps intended to lead to proper financing mechanisms. HEFA fully expects that organizations wishing to finance with them will, after enough meetings and tailoring, fit into one of a few tested HEFA tracks that leads to a bond sale.

Once organizations make contact with HEFA, the next steps in the bond issuing process largely depend on the kind of institution, health care facility or college, the size of the required financing, and the timing of the approach. HEFA acknowledges that some organizations have been "counseled" to explore financing options other than HEFA and is not at all defensive about the amount of dollars financed or the number of financings that have been done for some relatively few institutions. Simply stated, HEFA sees its mission as that of a bond issuing agency that is responsible only for bringing those organizations with the highest possible credit ratings to the municipal bond markets. Consequently, HEFA has brought and will continue to bring those organizations to the marketplace as often as they choose to borrow and as long as their balance sheets support the desired level of borrowing. Nonetheless, the Committee's interviews indicate that through the years HEFA has responded, although reluctantly, to various pressures to update and expand its offerings. Much of that pressure has come from aggressive institutional financial officers, backed by progressive professional advisers from the investment banking and municipal bond industries. But other changes, specifically the implementation of pool financings, largely resulted from the efforts of statewide service organizations such as the Massachusetts Hospital Association. Lobbying efforts of that organization, in the mid 1980's, coupled with the introduction of credit enhancements such as bank letters of credit and bond holder's insurance, literally opened HEFA to the broad range of lesser known 501 (c)(3) institutions throughout the state which had smaller dollar needs and were an unknown quantity in the municipal bond market with no credit rating. Prior to 1984, HEFA was primarily used by well known ivy league or Boston based colleges and universities and teaching/research oriented hospitals which were willing and had the endowment backed collateral to do large financings.

In addition, out of state banks with experience gained elsewhere with different kinds of municipal financings, teamed with Massachusetts institutions, pushed for and succeeded in getting HEFA to do variable rate as well as fixed rate financings. And so, slowly and with most of the pressure coming from outside HEFA, more options became available and more institutions were able to access the municipal bond market through HEFA. The change that occurred at HEFA with the inception of pool financings is succinctly described in a letter to the Committee by the current executive director. She said: "In 1984 the Authority issued its first Capital Asset Loan Program, which changed the complexity and nature of its lending activity. This is clearly demonstrated by looking at financings prior to the issuance of the pools and after. From inception through June 30, 1984 this Authority financed 112 major projects for 77 different institutions. Since July 1, 1984 we have financed 206 projects for 118 different institutions. Approximately 50% of these institutions have been new borrowers to the Authority. Forty percent of the borrowers since 1984 have been unrated."

The Committee's interviews indicate that once HEFA embraced new ideas, over the years its staff and advisers made additional improvements. The current HEFA Board and administration seem to be better staffed and more inclined to initiate activity than have been previous ones.

According to the Committee's research, HEFA handles each of its major client sectors--education and health care--somewhat differently, paying considerably more attention to the health care component. This attention, which includes closer scrutiny, cajoling and providing more options in the marketing of its bonds, appears to have resulted in a better understanding of that industry. Consequently HEFA has a more positive appreciation rating among its hospital users. Conversely, HEFA spends less time on all aspects of its relationships with its educational users, including, prior to 1985, limiting to two its bond marketing options. Several interviewed suggested this approach over the years has resulted in reduced opportunities for both the educational sector and for HEFA to take advantage of progressive and beneficial financing options available in the marketplace. HEFA officials maintain that market protocol and investment strategies demand that they take extra time with the health care industry. Basically, HEFA officials say the market, even after a number of years of trading them, is still leery of health care related securities and needs constant assurances that offerings are sound and backed by viable and sustaining revenue sources. In contrast, according to HEFA officials, the bonds of colleges and universities, particularly those of the better known and well endowed, are easier to sell.

HEFA officials also readily acknowledge that they are not interested in dealing with what they term risky credits or "junk" issues. HEFA critics, on the other hand, contend that there are interested bond buyers for almost any 501 (c)(3) institution, particularly one from Massachusetts. Additionally, the critics say, marketing them successfully really is just a matter of knowing various institutional strengths and weaknesses and finding investors who are willing to take related risks.

If interest conditions are reasonable, it takes four to six months to market a hospital bond issue and somewhat less time to do one for a college. HEFA maintains an extensive data base related to service delivery and financial performance of Massachusetts hospitals both in relation to each other and to their peer groupings elsewhere in the country. Additionally, there are mechanisms in place in Massachusetts that HEFA relies on to gauge whether it will become involved with a particular bond issue. Key among those is the determination of need process administered by the Department of Public Health which essentially determines a need for additional health care services or facilities and the amount that can be expended by institutions to construct or provide them. Also taken into consideration by HEFA are the rates that health care institutions can charge for their services. Control over those is under the jurisdiction of the state's Rate Setting Commission. The rate determination process is of particular importance for two reasons: 1) The rates set, including the portion reimbursed by the state for medicaid patients, clearly impacts on an institution's revenue and therefor its ability to repay bonds. 2) The amortization of capital costs is allowed in the rates established. Consequently, the costs associated with borrowing money are directly passed through in the rate to the patient in the ultimate cost of his/her health care. HEFA, except under extenuating circumstances such as existed this spring when the state was undergoing major changes in its health care reimbursement system, insists that health care facilities have the required state certificate of need in hand and all negotiations completed on its rate before proceeding with a bond issue. This is to assure adequate rate recognition of the costs and revenues needed. HEFA also requires that health care facilities undergo an extensive feasibility study to determine debt capacity. Done by consultant health care specialists, those studies detail actual as well as potential strengths and weaknesses in service delivery systems, marketing strategies and client base as well as financial and management systems.

There is no statewide or systematic sector wide review network in operation for the private, non-profit colleges and universities in Massachusetts that is responsible for making need based decisions of any kind. Consequently, decisions involving programmatic expansions and related facility construction and equipment purchases are solely the responsibility of each institutional board of trustees. Although HEFA also maintains a significant comparative data base relating to higher education, it does not require feasibility studies of colleges and universities before embarking on a financing. HEFA officials acknowledge that they are more inclined to rely on the information supplied by a particular college relating to its ability to maintain a continued and sustaining share of its student market. There is no provision in the HEFA process for any consideration of the relationship between the private and public sectors of higher education and its effect on maintaining market share and extended ability to pay off debt.

HEFA uses three methods to sell its bonds--private placement and negotiated and competitive bid public sales. The public sale is the most often used process and it is the one which is most labor intensive and time consuming. The nature of the public sale dictates the extensive and painstaking process which precedes it. No fewer than two dozen highly skilled and highly paid individuals from financial, legal and real estate firms representing HEFA, the institution, and bond dealers, insurers and rating agencies, spend months analyzing all facets of an institution. These individuals are responsible for determining which factors are favorable and unfavorable to the bond market and for deciding how best to present those factors or compensate for them, how to impress the bond buyer with them, or how to protect the buyer from them. The results of their efforts are summarized in writing and presented in what is commonly called the "offering statement" or bond sale proposal. That is the official document in a public sale that offers the bonds for purchase. It tells the "story" of the institution interested in borrowing money by means of a bond sale and details its solvency and ability to pay back the borrowed funds. Offered jointly by HEFA and the institution, it also specifies the terms of the sale and the conditions of the process for repayment. Additionally, it provides detailed descriptions of the project to be financed, of refinancing portions, if any, and of the securities that have been mortgaged by the institution to protect the investment. The offering statement also describes HEFA, its statutory function, powers, organization and Board, and the extent of its indebtedness. Federal and state laws require certain portions of the offering statement to be legally attested to which is done by law firms representing all parties. Finally, the statement contains certain assurances of solvency and level of risk supported either by the fact that the issue is insured or by the rating given the institution by the two nationally recognized municipal securities rating agencies.

HEFA, through its financial, legal, and real estate consultants, coordinates development of the offering statement and the production of the statement itself. Once that is complete, an appropriate time is selected and the bonds are put on the market. In the case of the negotiated sale, a team of HEFA managed underwriters--municipal bond dealers--negotiates with HEFA and the institution to determine the price at which the bonds will be offered. The bonds are then purchased by the underwriters and held or offered for resale through a network organized by the underwriters. Issues that are sold by competitive bid are offered for sale on a single day and the bonds are sold to the broker or investment firm with the most advantageous bid.

Private placements are somewhat less complex and less formalized. Usually, the institution or HEFA has identified an institutional or individual buyer for the bond issue at the outset. In private sales, it is common for all three parties--the institution, HEFA and buyer--to negotiate terms. HEFA generally uses this option for new and lesser known borrowers. Additionally, all three methods are used for what is referred to as "stand alone" financings, those issues which are done for a single institution.

The four loan pools were issued in lump sums. Two are available to qualified institutions on a rolling basis, similar to a line of credit or equity loan. As borrowers repay loans, the funds in turn are made available to other institutions. Each pool series was issued as a variable rate demand bond and is supported by a credit facility in the form of either a major bank letter of credit or municipal bond insurance guaranteeing repayment. The pools additionally are backed by a liquidity facility which provides cash in the event remarketing of the short term bonds is impossible or delayed.

D. Costs of HEFA Financing

The HEFA bond process is designed to culminate in a transaction, the bond sale. Consequently, all of the payments for services rendered during the process are transaction based and all of the multitude of players, including HEFA itself, receive payment in portions of the bond issue. Under federal laws, the issuance costs that can be wrapped into the financing currently are limited to two percent. If the deal involves fees greater than two percent of the issue, the institution must pay them from other fund sources. HEFA promotes itself as an issuer that has focused on keeping issuance cost as low as possible over the years. HEFA officials claim that their management of the issuance process has made HEFA's the lowest issuance costs of like agencies in the country. According to HEFA, these low costs, coupled with the tax free nature of the bonds themselves, "produce substantial savings in financing capital projects. These savings can then be passed on in the form of reduced expenses for health care and lower tuition to students."

However, despite HEFA's claims, the costs for health care and private higher education in Massachusetts among HEFA financed institutions are some of the highest in the country. Many of those interviewed pointed out that they find the HEFA process expensive and one which includes costs to the institution that are not found in HEFA-like systems in other states. For example, two financings were in process during the Committee's study. In the first instance the principal amount of the bonds was approximately $59.8 million. The costs associated with that issue totaled about $2.8 million and included $1.3 for bond insurance, $850,000 in legal, financial and other issuance fees, including fees to HEFA, and $700,000 in underwriter's fees related to the sale. The second financing was for approximately $26.9 million and the costs associated with that financing totaled about $1.35 million, with $608,000 for bond insurance, $400,000 for issuance expenses and $335,000 in underwriter's fees. Additionally, the second institution was required to establish a debt service reserve fund of approximately $2.35 million. This requirement adds to the total amount financed and consequently to the total interest costs to the institution. In both cases, costs associated with the bond issues were approximately five percent of the face value of the issue. Since bonds are issued in $1,000 denominations, this means that about $50 per bond, exclusive of the debt service reserve requirement of the one institution, is being spent for fees of one kind or another.

From all of this, the Committee basically concluded that borrowing money through HEFA and the municipal bond market is a very labor intensive, complicated and competitive process. Consequently, it is a very expensive process and the margin for savings is narrow, with much of the margin governed by timing and luck, i.e., when a particular bond issue is marketed and the prevailing rates at the time of marketing. However, the Committee also acknowledges that experience with the Massachusetts municipal market, which HEFA has aquired over the past 20 years, certainly provides a competitive edge in judging the timing and in other market nuances which often result in savings. Institutions contacted chose to finance with HEFA primarily because the interest on the bonds issued is tax free, making those bonds less expensive and more desirable. Those interviewed considered the fees a cost of doing business. Although they felt some of those fees can and should be eliminated, they did not make comparisons with other states or financing sources and remain willing to pay the fees to obtain the tax free financing.

E. HEFA and the Cultural Community

The Committee feels that HEFA, while applying a limited interpretation of its mission, provides advantageous services to various kinds of institutions. For two decades it has provided these services in an efficient and professionally meticulous fashion. HEFA provides an opportunity for acquiring capital funds and examples are numerous of how those funds have been used to enhance health care, educational and other services in Massachusetts. HEFA's existence has resulted in a broad based enhancement of the quality of education, research and health care available. However, the Committee feels the narrow mission focus and a reluctance to do aggressive outreach has served to shortchange some organizations, particularly those in the cultural sector. For example, HEFA has done only six financings for cultural institutions in the seven years it has been authorized to do them and three of those were done on behalf of organizations that helped draft the statutory changes which made the financings possible. There are 599 cultural organizations registered with the state Revenue Department as having 501 (c)(3) status. Other published sources, like the New England Foundation for the Arts, sets the number of cultural institutions in Massachusetts closer to 1,500. Admittedly, a large portion of these are small organizations that may not have the desire or the need to get involved with debt financing. However, Committee interviews indicated that there are considerably more than six cultural organizations that are interested in the HEFA financing option. Many interviewed acknowledged that the majority of cultural organizations in Massachusetts are inexperienced in financial matters and probably lack the extensive assets usually required by HEFA. However, all interviewed felt that HEFA has some responsibility to work with the cultural sector more extensively to explore all financing possibilities.

Several interviews revealed that cultural organizations in Massachusetts have undergone a great deal of financial maturing over the past decade. Cultural administrators told of developing more sophisticated systems for raising revenues and managing operations, making it possible for them to clear original, start-up debts and begin building reasonably sized endowments. Interviewees pointed out that as a Massachusetts industry, cultural organizations are relatively young. However, they also provided details showing that the industry has been strengthened over the past decade into one with a sizable impact on the Massachusetts economy. For example, two studies done over the past 18 months estimated the statewide economic impact of the non-profit cultural industry in Massachusetts at approximately $2 billion a year and at $500 million a year for the city Boston. Additionally, the industry is that city's third largest nongovernmental employer.

When queried about the absence of cultural organizations among the list of HEFA users, those associated with HEFA and some in the financial community expressed the opinion that most cultural organizations were ineligible for HEFA services and that the bond market would be leery of investing in that sector. However, others were more positive and said cultural organizations were not well understood and that aspects of their worth, particularly government grants, are undervalued by HEFA and others and need to be updated in light of management and other changes in the industry.

When queried about their lack of involvement with HEFA, cultural organizations themselves and arts administrators throughout the state cited two main reasons: 1) lack of knowledge about HEFA and its purpose, and 2) a prevalent perception among the cultural community that arts related organizations were not welcome at HEFA. In the words of one, "The cultural community of Massachusetts is like a small town...when one or two of its members are rejected or have an unpleasant experience, word spreads fast." That person added, "HEFA has told some arts organizations they are not eligible and to go elsewhere."

HEFA looks to its enabling statute as justification for deeming most cultural institutions ineligible for its service. The statutory language states that in order to qualify for HEFA services, cultural organizations must be a major regional resource, provide advanced level educational services either to its own or other students and demonstrate broad community support through its fund raising abilities. Interestingly however, state and federal sources have combined over the past decade in awarding approximately $75 million in grants to Massachusetts cultural organizations. Additionally, some of these funds have been matched and enhanced by corporations and foundations, boosting the total invested in this industry to more than $100 million. Key among the criteria considered in the awarding of these funds is the regional service potential and educational services provided by those institutions. In addition, a recently published study on corporate giving pointed out that the arts world nationally is currently benefiting from an annual business contribution of nearly $500 million which is included in an annual corporate giving program that approaches $5 billion. The study, done by the American Council for the Arts, reported that in evaluating an application for arts support, corporate donors place a special premium on the proposed program's value to a particular region and to the cultural organization's management.

The Committee feels that HEFA needs to re-evaluate its position on cultural institutions and possibly other 501 (c)(3) institutions for which HEFA is authorized to secure financing. The HEFA Board has taken an important step by recently appointing a special committee to examine ways to improve HEFA's image and its community relations. And the Committee was encouraged to hear some Board members suggest that this committee should eventually re-examine HEFA's approach to its stated mission.

IV. THE ADMINISTRATIVE ENTITY

The geographic service area for those professionals who work with HEFA is fairly broad, extending beyond the Massachusetts municipal bond market to bond markets along the entire eastern seaboard. Several professionals are connected to firms that have public finance units throughout the United States. Most acknowledge that, although each state has individual differences, there are only two principle administrative alternatives for state bond issuing authorities. The most common is for the agency to lend its statutory powers to institutions seeking financing as a "conduit" or "pass through" entity between the institution and the municipal bond market. It is also possible, as did Massachusetts' HEFA, for the issuer to become a known entity in its own right, developing a reputation and market constituency. The sizeable volume of the Massachusetts municipal bond market and the fact that the state is home to some of the wealthiest and most prestigious 501 (c)(3) organizations in the country encouraged the aggressive entrepreneurs and professionals who were part of HEFA's initial administration to step off on the latter course. Additionally, until 1988, Massachusetts laws limited bond issuing powers for non-profit organizations to HEFA. In some states, particularly in the Midwest, it is common for hospitals and others to have a choice of several bonding authorities, such as state, local and/or county issuing agencies.

The Committee's research and campus visits clearly established that Massachusetts' HEFA, over the past twenty years, has become known as an issuer of strength and quality. Even HEFA's critics first take time to elaborate on its accomplishments and meticulous style before enumerating its perceived shortcomings. Visits to more than twenty institutional complexes where some of the $5.7 billion in bonds have been used to finance capital construction or buy equipment visually demonstrated for the Committee the significance of HEFA. The clean fresh look of new or renovated buildings are architecturally interfaced with the antiquated and classic at colleges, universities and health care facilities throughout the state. The beneficiary institutions range from Youville Hospital and Rehabilitation Center and Boston University in the Boston area to Central New England College and Memorial Hospital in Worcester and Mt. Holyoke College in South Hadley and Holyoke Hospital in Holyoke. In some cases, HEFA financing has made possible the construction of major portions of an entire campus and at others it financed those facilities or renovations, such as power plants or walkways, that are not popular with otherwise generous benefactors. In all cases, institutional representatives concur that HEFA has become an important factor in the development of the private college and health care industries in Massachusetts during the past two decades. Those interviewed say that because of HEFA's strong and well defined administrative structure, its impact on those industries has achieved greater significance than would that of similar agencies functioning as mere conduit bonding agencies.

To establish its own status and reputation, distinct from the 501 (c)(3) institutions it serves, HEFA has, over the past two decades, become not only an active participant, but the controlling participant, in the bond issuing process. Those directly connected to the Authority maintain that HEFA has set up a series of necessary "quality thresholds" which are well known and respected among all operatives in the municipal bond market. They say that if a financing is done by HEFA, it is of known quality and "it is done the right way." Furthermore, those connected with the Authority say, if HEFA steers an issue to the public bond market it is "generally of the highest quality investment grade."

HEFA's process control and ensuing "quality" controls are built primarily on consistency; HEFA has changed very little about its process over the years. More importantly, the Authority has principally relied on non-staff consultant advisors to manage its process, with as few as three individuals offering the key advice on most of HEFA's activities for more than two decades. Although there are several interests in each bond transaction--the institution, the bond buyer, and HEFA--and several key players--investment bankers/financial advisers, lawyers, real estate appraisers, health care finance experts and bond underwriters (dealers)--it is HEFA's interest that gets priority and it is the Authority which controls the selection and fees of the transaction principals. Consultants selected by HEFA determine whether the financing will be done and all of the terms associated with it, including the financing mechanism and the collateral that must be pledged by the institution.

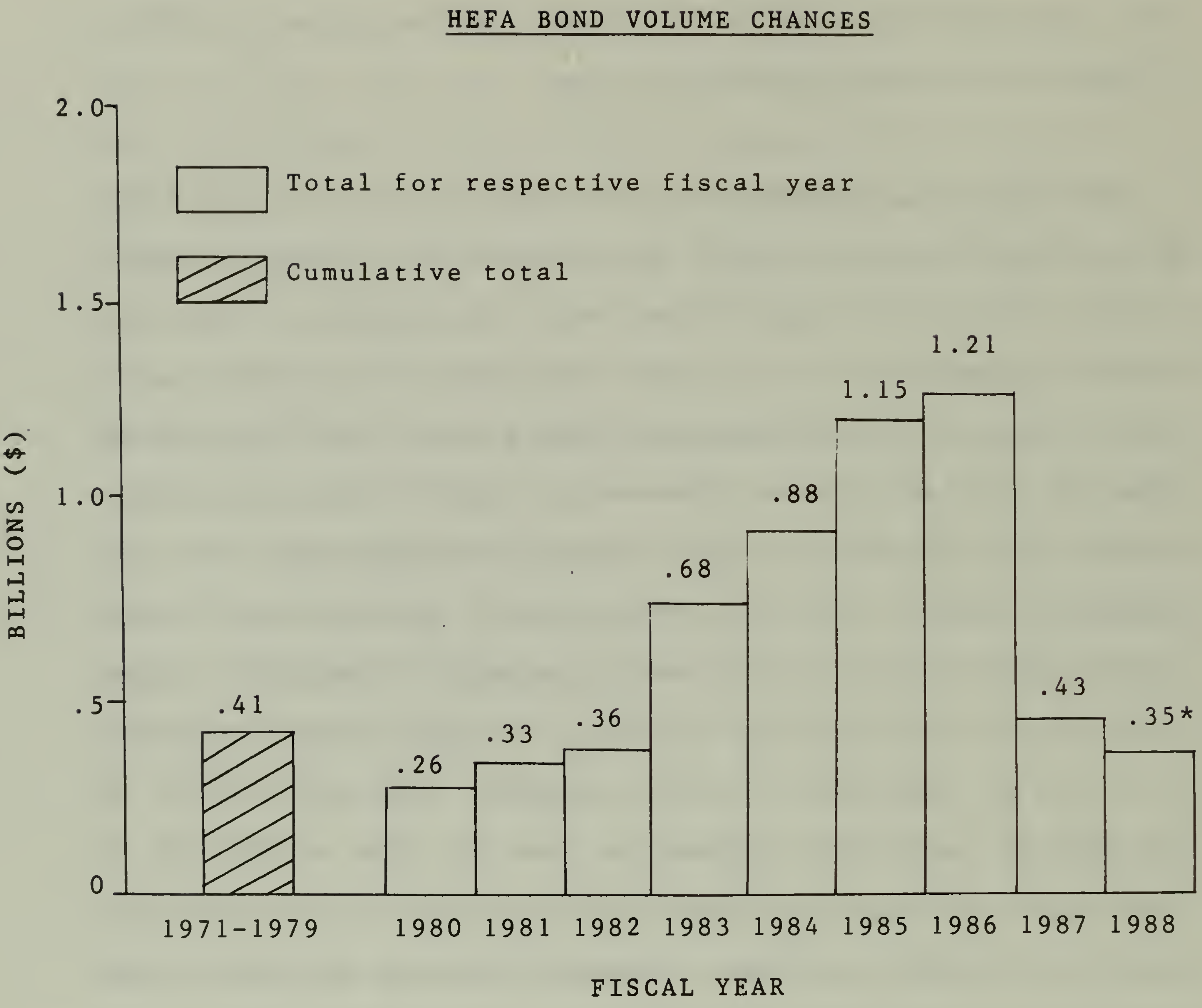
Adding significantly over the years to HEFA's position of strength has been the continued availability of an unrestricted and comfortable administrative budget. The Authority's budget relies on fees paid by financing institutions and is tied to the bond volume. The availability of administrative funds in sufficient amounts, and free of the normal constraints imposed on more typical public agencies, has been an important factor in HEFA's abilities to operate and negotiate from strength and to hire consultants of choice and pay them well. For example, except for a brief start up period in the early 1970's, HEFA's revenues have always exceeded expenses. Consequently, the Authority has ample operating funds and a surplus which has grown over the years to total approximately $11.5 million. These funds are held in an unrestricted reserve and they are conservatively invested, providing an additional source of administrative purpose revenue which reached approximately $675,000 in fiscal year 1988. HEFA has no specific written guidelines detailing the uses of this reserve fund and Board members interviewed were divided both on whether it should be used at all and the purposes for which it should be used. During the past two years, funds from the reserve have been used to pay consultant fees for teams of various experts working with as many as six institutions experiencing serious financial difficulties, and to defray the cost of processing fees related to pool loan funds.

The policies and administrative framework that set Massachusetts HEFA apart from its peers is easily discernable in an analysis of its annual operating budget. Its size--currently at $1.77 million--is not an issue when framed against the coordinating effort involved in issuing $5.7 billion in bonds or against the fiduciary responsibilities of monitoring the approximately $3.9 billion in bonds still outstanding. Neither can criticism be leveled at the management style supported by the HEFA administrative budget as amounts allocated for staff salaries, office space and administrative support, supplies and activities are all well within reasonable limits. However, the Committee finds particularly disturbing the unusually high percentage, consistently between 60 and 80 percent, of the Authority's recent budgets which is apportioned to consultant fees. This is particularly significant because the monies, with few exceptions, have been paid over the twenty years of HEFA's existence to the same consultants or firms.

For example, approximately $5.2 million was paid in consultant fees during the past four fiscal years, the period of HEFA's highest volume of activity (Figure 2). Almost 90 percent of that consultant money--$4.65 million--was paid primarily to three firms, one for legal and two for financial advice. During those years, HEFA's annual operating budget was between $1.6 and $2.5 million. Because fees paid for legal and financial services are recorded in HEFA's operating budget they are easily analyzed. However, there are also some fees, such as those for real estate related services and for health care related feasibility studies, which are paid directly by the institution for HEFA required work. These could not be determined or easily analyzed. HEFA also controls the selection of consultants, whether the fees are paid by HEFA or the institution, although more firms now are involved in the health care feasibility studies as a result of specific legislation filed in 1979. But the real estate work has been done by one firm throughout the years.

With all bonds issued in $1,000 denominations, it is interesting to note that, based on volume of bonds issued, HEFA paid consultants $1 for every bond issued in fiscal 1985. HEFA issued $1.1 billion in bonds that

FIGURE 2



*Estimated figure

year and paid out approximately $1.2 million in consultant fees, or 75 percent of its budget. In fiscal 1986, the bonds issued increased only slightly to $1.2 billion, but the same cadre of consultants gleaned $2 for every bond issued, with HEFA spending more than $2 million, or 81 percent of its budget, on their fees. Fiscal 1987 and 1988 have seen dramatic drops in volume, down 64 and 73 percent respectively from fiscal 1986 volume. However, HEFA has continued to pay $2 or more per bond, primarily for legal and financial services.

HEFA does have a process, instituted three years ago by the current administration, through which all consultant contracts are reviewed, some every two years, others every three years. The process is thorough, with an extensive request for proposals circulated asking for a variety of information about the firm, including its experience, staff expertise, certain kinds of business volume, and willingness to commit resources to HEFA clients. However, although additional firms have been added, the same firms also have been awarded new contracts. HEFA adamantly maintains that those repeatedly awarded contracts are the best available in the business. Additionally, HEFA points out that contracts are awarded based on a firms willingness and ability to give HEFA clients priority staff and to make other commitments that other firms do not have either the expertise or willingness to make. HEFA maintains that a top notch reputation and priority commitments are vital to the Authority's quality control.

The Committee appreciates HEFA's position related to its consultants and agrees that change for the sake of change is not good public policy.

However, the Committee suggests that opportunities for constructive change are remote under a system such as HEFA's in which there is such a direct and advantageous link between "tried and true" advice, successful bond closings and lucrative fees. This is particularly true at HEFA where the institutional client has little or no leverage on the consultant handling its transaction and the consultant has no direct interest or involvement with the institution's interests or those of the industry or the state as a whole.

By contrast, in many other states, the institutional client comes to the bargaining table with its own investment banker or financial consultant and that individual does all the institution's negotiating with the bond buyers and underwriters (bond sellers). The majority of institutional representatives interviewed were very uncomfortable with the HEFA system under which one financial adviser of HEFA's choice handles all transactions. Several interviewed said they felt "unprotected" and that they rarely get the individualized attention or consideration possible in such deals. For example, those interviewed said that in direct, institutional to bond buyer negotiations, the bond buyer often requires less collateral than HEFA requires which reduces considerably the legal, real estate and other fees involved and leaves the institution less restricted for future financings or other financial dealings.

HEFA has, over the years, required many institutions wishing to finance to commit the dual security of its main revenue source--tuition or health care service delivery income--and a mortgage or property lien. The majority of those interviewed say this requirement is: 1) of dubious market value because the buildings and equipment of single purpose institutions have little value for anything else and 2) an unnecessary and expensive requirement for the more credit worthy and/or repeat user. Additionally, several interviewed said the municipal bond markets have long accepted financings that are backed only by a revenue source.

HEFA, on the other hand, maintains the dual collateral requirement is necessary and that it "protects the bond buyer" and, therefore, protects the state's interest. The Committee, however, observed during the audit that this one HEFA requirement alone results in institutions having to come back to the Authority repeatedly for changes, updates and other permissions relative to real estate. A situation of this nature, with one party having to constantly rely on another to lift or change restrictions, cannot help but enhance HEFA's leverage over its client institutions.

In addition to being the chief negotiator for the institution and determining the extent of required collateral, HEFA's financial adviser also has a great deal to say about the limited number of financing mechanisms that have been used over the years. That advisor also helps HEFA manage its underwriters contigent--the team of people who sell or market HEFA's bonds. As is the case with all other services, HEFA carefully manages its underwriter pool. Currently there are four financial firms represented which take full responsibility for a bond sale on a rotating basis as the bonds are ready for market. At various times there has been a greater number of firms represented, but HEFA has always limited the firms to those of its choice. Only those firms selected by HEFA can market negotiated issues. HEFA maintains that this system provides the best quality service for its constituents and assures the lowest cost since under this system the issuer is able to influence underwriter's charges for marketing the bonds, commonly referred to as an underwriter's discount.

Recent statistical analysis done by HEFA comparing issuers with a managed system and those without one support their position. However, Committee interviews indicate that the managed system weakens once bond volume drops to a point below which it is both lucrative and desirable for top notch, nationally prominent investment firms to commit resources and senior staff to an assignment. Several of those interviewed indicated that HEFA, with declining volume and new competition for its 501 (c)(3) clients, is approaching this point. In addition, those interviewed said, restrictions imposed by HEFA and its financial adviser over the years limiting the way bonds could be marketed had the effect of preventing firms within the underwriter's pool from fully utilizing the skills and talents that are their trademarks and for which they were initially selected by HEFA. Those interviewed suggested that Massachusetts institutions were shortchanged by this and denied the benefits available from the various creative market instruments and other state of the art financings generally recognized in the bond market. By contrast, in other states, more of an attempt is made to structure the financing to suit the institution's circumstances rather than the formulas and policies of the issuing agency. In those states, the 501 (c)(3) organization often comes to the issuer with a buyer or bond marketing firm already identified and is able to negotiate the terms of its own deal.

In summary, the Committee's research and interviews established that HEFA is widely recognized as an issuer of quality and one with a reputation in its own right. However, HEFA is also considered to be rigid, aloof and insensitive to the needs of its client organizations and its public mission. Those organizations which use it recognize that HEFA is a force to be reckoned with if they want continued access to tax free debt financing. At the same time, most are encouraged by recent legislative action giving some 501 (c)(3) organizations the option of financing with MIFA (Massachusetts Industrial Finance Agency), and look to that action to provide the incentive for constructive changes within HEFA. All those interviewed said they will compare the services offered and costs of both issuers before proceeding with their next financing.

V. THE YEARS AHEAD

As HEFA enters its third decade of tax exempt bond issuance, it is anticipating and strategically planning for many future possibilities. Chief among these are the negative impact on its operations of federal tax law changes, those already enacted as well as those under consideration, and the current volatility of the securities market. Also being weighed are the ramifications on HEFA's outstanding debt of both demographic changes which may result in a dwindling pool of college applicants and of continually rising health care costs and the resultant regulatory and market reactions.

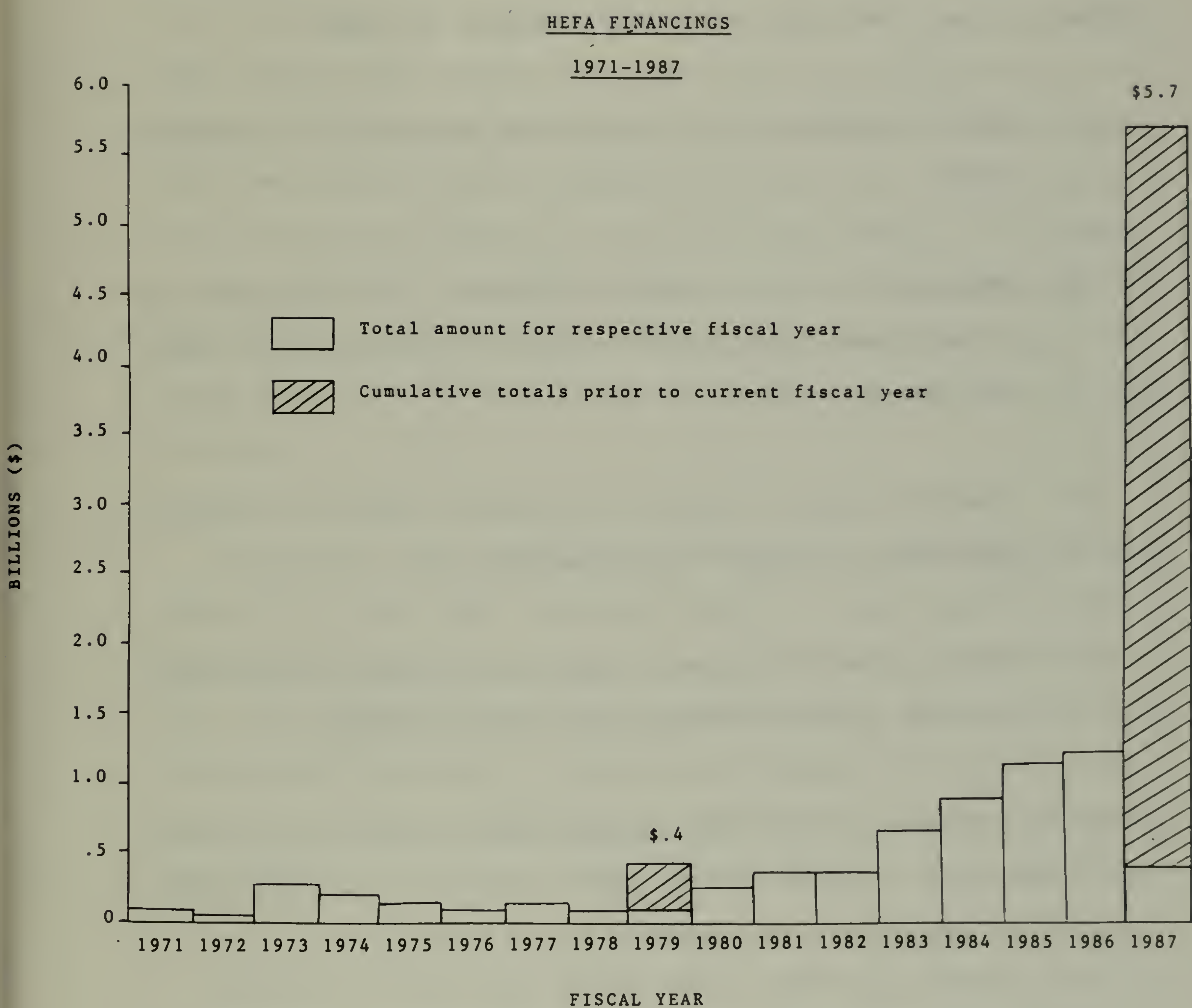
On the other hand, there is at least one major blip on the horizon of HEFA's third decade that has not been anticipated nor planned for--the potential impact on its business of sharing its client base with another issuer. On January 14, 1988, Chapter 769 of the Acts of 1988 was signed, giving the Massachusetts Industrial Finance Agency (MIFA), authorization to do tax exempt financings for a large percentage of the same 501 (c)(3) organizations previously required to finance exclusively with HEFA. This action caught HEFA by surprise and has caused the Authority to reassess some of its long held beliefs and practices. A further complication arose in July, 1988 when further legislative efforts were made to merge HEFA completely with MIFA.

As previously discussed in this report, 1986 federal tax law changes affected HEFA by making ineligible for further non-taxable bond financing its three largest clients. In addition, other clients are approaching the $150 million cap established by that tax law. Consequently, HEFA's bond issuing volume has declined precipitously since 1986 and is expected to level off eventually at between $400 and $600 million. Moreover, the Authority anticipates additional changes further limiting benefits now available to 501 (c)(3) institutions and hence does not expect to recover to the volume issued during the 1980's (Figure 3).

In addition, rising health care costs, coupled with state and federal funding reductions for inefficient and less than full service health care operations, has led HEFA to take several steps over the past 18 months to protect itself and bondholders who have invested in the Massachusetts health care industry. Several interviewed suggested that HEFA is, in fact, preparing to deal with its first case of default on a health care related bond issue.

However, while some authorities in other states already have had defaults among their higher education constituency, HEFA is not at all concerned about the ability of its college and university clients to maintain the enrollments necessary to produce sufficient revenues to cover outstanding bonds. HEFA insists that its information and analysis support its confidence that higher education institutions in the eastern United States can "ride out" the predicted demographic downswings "without serious effects" on enrollment and the subsequent ability to uphold bond covenants. In a position strongly supported by the statewide service organization for non-public higher education in Massachusetts, HEFA maintains that those institutions will continue to draw students because of their international reputations and known high quality.

FIGURE 3


HEFA FINANCINGS
1971-1987
6.0
5.5
5.0
4.5
4.0
3.5
3.0
2.5
2.0
1.5
1.0
.5
0
BILLIONS ($)
$5.7
$.4
Total amount for respective fiscal year
Cumulative totals prior to current fiscal year
1971
1972
1973
1974
1975
1976
1977
1978
1979
1980
1981
1982
1983
1984
1985
1986
1987
FISCAL YEAR

HEFA Board members and its executive director readily acknowledge the necessity of the Authority shifting its emphasis from being primarily a large volume issuer of bonds to one of being more the caretaker of its outstanding debt. They are able to enumerate several administrative changes already made to facilitate that adjustment including:

1. Adding significantly to the size and diversity of its in-house staff;

2. Development and consistent utilization of a sophisticated industry peer group analysis routine, particularly for health care related clients;

3. Scheduling regular briefings by national experts on municipal bond default strategies and proceedings; and

4. Creating teams of nationally experienced advisers to assist HEFA staff and to work with financially troubled borrowers.

Since its revenues are declining, although they are not yet at a point where they match or exceed expenses, HEFA is relying on its $11.5 million reserve to finance much of this activity.

Committee interviews indicate that very few of HEFA's client institutions are aware of most of HEFA's agenda for the 1990's, of its intentions, or even of the existence of its reserve fund. However, all of those interviewed who represent client institutions expressed pleasure with the addition of permanent staffing for the Authority. It is a move that most, including HEFA Board members, say is long, long overdue. Most institutional representatives were impressed that HEFA had accumulated a reserve, but did not feel it was within their purview to dictate how it should be spent. On the other hand, almost all would appreciate being asked to help HEFA identify items and issues to be supported by it. A number, including some Board members, felt some of the reserve money should be spent on creative approaches that could help the state solve a part of the pressing problems in the health care industry. For example, it was suggested that HEFA's advisers could develop innovative and non-standard approaches to turning existing underutilized space into needed facilities for rehabilitative care, long term illness or AIDS treatment.

In addition, those interviewed felt that HEFA needs to pay much more attention to the higher education industry. Some expressed concern relating to future tax law changes that may impose an inclusive cap on the total amount of non-taxable debt allowed. Those interviewed suggested HEFA would have to apportion bond funds in some fashion within an industry that is unaccustomed to prioritizing needs on an industry wide basis.

Regardless of which part of its 1990's agenda was discussed with the Committee, it was evident that HEFA was unaccustomed to including either its client institutions or others in its strategic planning. As discussed previously, HEFA intentionally has limited its interpretation of its statutory mission and views itself strictly as a bond issuing agency. HEFA representatives say that to assure a strong competitive edge, HEFA's systems and approaches must be sensitive more to the securities market than to public perception or preference. But, apparently it was this "non-user friendly" approach and perceived insensitivity which prompted some within the 501 (c)(3) community to seek an alternative route for debt financing and to push successfully the enactment of chapter 769 of the Acts of 1987. As noted earlier, that law authorized MIFA, another quasi public agency, to provide tax exempt financing to a large number of the 501 (c)(3) organizations that previously could obtain that type of financing only through HEFA.

MIFA, unlike HEFA, has a solid reputation as a "user friendly" agency with a strong and proven public service record. For at least a decade, MIFA has been well known as a source of growth capital for small Massachusetts companies and the agency developed a favorable reputation with state legislators and administrators by, among other things, successfully parlaying its start up appropriation into small loan funds to initiate new ventures in the seafood and child care industries. As of July 1, 1988, MIFA had issued $250 million in tax exempt bonds for its new 501 (c)(3) clients. MIFA, unlike HEFA, relies heavily on permanent staff to work with potential clients and already has committed significant staff time and efforts to its new initiatives. Most important, MIFA's outreach to its new client pool has been extensive and positive. To cultural institutions, a large cross section of educational organizations, and others, MIFA has stressed its willingness to be flexible and to structure financings "to suit institutional needs." This is reaffirmed in both its written materials and its informational meetings. MIFA is clearly experienced in "state of the art" financing techniques, is willing to use those, and is not excluding any possibilities for marketing vehicles or bond sellers. Furthermore, MIFA has experience with financings involving several 501 (c)(3) organizations.

Views on the impact of dual HEFA/MIFA enabling laws are mixed. The majority of those interviewed, including some directly connected to HEFA itself, feel that the new law, and the competition it will foster between HEFA and MIFA, initially will be beneficial to Massachusetts 501 (c)(3) organizations. The primary benefit is seen in the competition that will be generated among investment bankers who deal in the state's municipal bond market. It is suggested that profit margins will be cut and more creative financing packages developed in order to attract clients of both agencies. All representatives of 501 (c)(3) organizations interviewed said they will compare the offerings of both agencies before doing another financing. However, most also indicated a reluctance to alienate HEFA because of the potential for subtle retribution.

There are others who feel very strongly that the new law is a mistake that will have costly negative effects on 501 (c)(3) organizations and hurt the state in the long term. This group feels it has been very advantageous for Massachusetts to have but one quasi public agency--HEFA--issuing paper on behalf of 501 (c)(3) organizations and providing the municipal bond market with a well known commodity. The change, they feel, will weaken the value of the Massachusetts paper. However, the majority of those interviewed said that it is the individual institution and its bond rating which is considered by the bond buyer, not HEFA, and the institution's value is identical regardless of the issuer.

The emergence of external challenges, the reality of competition, and the possibility of a merger have had a noticeable effect on HEFA. These issues have distracted administrators and Board members from other business and, although commentary about the change is guarded, it is apparent that the new law and activities surrounding it caught HEFA by surprise. The situation was openly discussed at two Board meetings held during the audit and resulted in finalization of details for a new Board standing committee and approval of a $75,000 expenditure to improve HEFA's image. Some HEFA representatives queried during the audit seemed genuinely unaware of the details, but most were aware that the legislative action resulted from a build up of dissatisfaction with aspects of HEFA's conduct. However, one Board member said it would have been preferable to be told "directly" about the dissatisfaction instead of waking up one morning and finding another issuer with overlapping jurisdiction. He said, "If we are not performing as expected, first light a fire under us...and, if we still don't perform, then get rid of us...but to give two quasi public agencies in one state the same constituency in competition does not make good business sense."

HEFA's administration has responded to the competition by aggressively analyzing costs of financing proposals submitted by its clients to MIFA and flagging those they consider excessive. Additionally, they are weighing various strategies to increase their visibility and effectiveness with other state entities. Others, however, have responded by making a legislative bid for merger of the two agencies.

The Committee feels it is too early to make any determination of long range benefit or harm resulting from either having two financing agencies for 501 (c)(3) organizations in Massachusetts or from a merger of the agencies. The Committee does agree with those who predict an initial benefit and possible cost savings from having two agencies competing in an arena previously controlled by a single, dominating agency. Whatever the resolution to current merger attempts, careful monitoring of events over a longer term will be the only means to judge the impact of the changed situation and to protect the state's interests, the interests of current HEFA issued bond holders, and the interests of the state's 501 (c)(3) organizations and the economically important industries they constitute.

VI. SUMMARY AND RECOMMENDATIONS

In the twenty years of its existence, the Massachusetts Health and Educational Facilities Authority has become the largest issuer of municipal bonds in the state and one of the largest in the country. To date, the Authority has issued $5.7 billion in tax exempt bonds on behalf of 135 of the state's 501 (c)(3) organizations, primarily colleges, universities, and hospitals. In addition, it has issued bonds on behalf of other health care related facilities, cultural institutions, schools for the handicapped and one nursing home. In the process, HEFA, unlike most of its peers in other state, has focused much of its attention on developing a reputation and identity of its own as an organization with influence and power separate and distinct from its client institutions. For some purposes, this course has been advantageous. HEFA is widely known for its flawless process and its ultra conservative financing techniques which have, over the years, assured buyers of Massachusetts paper access to prestigious and top rated bonds without incident of default. On the other hand, HEFA's preoccupation with its own agenda left the Authority principals with little desire or resources to effectively monitor and respond to the changing needs of its constituents as they grew and developed into succinct and economically sophisticated Massachusetts industries.

This review by the Senate Post Audit and Oversight Committee found HEFA in a vulnerable position. The Authority is past its bull years of large and multiple issues; tax reform took a lot of the glitz off its appeal by eliminating positive arbitrage opportunities and capping big users. With its issuing activity at a minimum, it is now left with the very unsexy job of tediously managing, for decades, $3.9 billion of outstanding debt.

Coincidentally, statutory changes have made it necessary for HEFA to compete for what bond business is left, a situation that is proving to be uncomfortable, at best, for HEFA. And, during the course of this audit, legislation was proposed to eliminate HEFA as a distinct entity through merger with the Massachusetts Industrial Finance Agency.

In spite of these challenges to HEFA, the Committee feels HEFA's situation easily can be as opportunistic as it is difficult. The Authority, at its April meeting, took the necessary first step by establishing a Board level committee to review HEFA's "image." The consensus was also expressed for an eventual review of the Authority's entire mission. The Committee supports HEFA in this move, agreeing that it should immediately pursue a review of its mission, taking into consideration all of the current events impacting on the way it conducts business, its client pool, and the potential effects of competition or merger.

HEFA has traditionally sought sound advice in its financial dealings. The Committee recommends that HEFA use this same tactic in analyzing its mission and matching its approach and current services against the current needs of the industries it was designed to serve. The Committee urges HEFA not to go through this process in isolation, but to involve the many others who are impacted by its operations. The

Committee suggests the Authority consider one or some combination of the following for involving others in its mission and/or image review process:

1. Assemble a blue ribbon task force to do the entire review or assist in a meaningful way with critical segments. It should be chaired by a Board member or executive director from a "cutting edge" authority outside Massachusetts, but should include as members chief fiscal officers of client institutions and representatives of public agencies related to HEFA served industries and of state wide industry service organizations as well as finance professionals.

2. Turn to the talented group of investment bankers and others already available to the Authority and ask for advice. Some firms already have experience advising lay boards on mission definitions and organizational matters.

3. Turn to a new consultant who could approach the situation from an unbiased perspective. There are many in the Boston area with a proven track record of advising Board members of 501 (c)(3) organizations on such matters.

Assuming HEFA's survival, the Committee believes that its board will play a critical leadership role in the process of carving a new niche for the Authority in the state's municipal bond market. Consequently, Board appointments must be reviewed carefully. There are currently three vacancies on the HEFA Board. The term of one member expired in July of

1987 and those of two others expired in July of this year. A fourth vacancy will occur in July, 1989. The Committee recommends that the Governor reserve at least one of the current vacancies for an official from state government to assure a more direct tie between HEFA's activities and the state's policy agendas in the areas of education, health care and cultural affairs. The Committee also recommends that the Governor consider appointing someone with affiliations in the cultural community to fill another of the three vacancies and to strengthen HEFA's relationship with that constituent group.

As detailed in this report, the decade of the 1990's will be a difficult one for industries served by HEFA. The Committee feels it is vital for HEFA to become more involved with its clients and with those public sector agencies that may be involved when and if worsening financial woes result in the closing of institutions with outstanding bond issues. Additional, regular and more open communication between HEFA and its client institutions will assist in the effort of reshaping the focus of the Authority for the next decade. Consequently, the Committee further recommends that HEFA:

1. Initiate a policy of regular staff-to-staff communication with state agencies, particularly those directly involved with HEFA's clients, such as the state Rate Setting Commission, various units of the Public Health Department, and the Executive Offices of Human Services and Administration and Finance.

2. Develop a formal and systematic meaningful way in which HEFA users can participate in the decision making process of the agency in areas such as changes in collateral requirements, financing vehicles, the role of financial advisers, client recruitment, fee structures, guidelines for use of reserve monies, and so forth. One possible means to accomplish this is through a small advisory unit with input to the Board and/or administration.